

Bajaj Allianz Life Insurance Co. Ltd.



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Macro-economic developments

- US non-farm payrolls rose by 136,000 in the month of September, coming in below expectations. However, the unemployment rate fell to a 50 year low of 3.5%.
- The US Fed cut rates by another 25 bps cut in its September 2019 meeting to 1.75% – 2.00%. The median Fed rate forecast for 2019 was cut to 1.9% in the September meeting from a forecast of 2.4% in the June meeting. This

indicates no room for more rate cuts in 2019. However, the Fed Chairman commented that their forthcoming decisions will be data dependent, and indicated that if the economy fades, then rate cuts will be intensified. The European Central Bank (ECB) also cut its benchmark deposit rate by 10 bps to a record low of -0.5% in its September 2019 meeting, and announced that it will restart bond purchases (quantitative easing) of 20 billion euros a month from November 2019.

- US GDP growth for Q2 2019 (second estimate) slowed down to 2.0%YoY from 3.1%YoY in the previous quarter. Consumer spending, which accounts for more than two thirds of U.S. economic activity grew by a robust 4.7%YoY in Q2 2019, making it the fastest pace of growth since Q4 2014. However, this strong growth was offset to some extent by declining exports and smaller inventory build-up. Eurozone GDP growth also slowed down to 1.1%YoY in Q2 2019, mainly led by slowdown in Germany whose GDP growth dipped to 0.4%YoY in Q2 2019, from 0.9%YoY in the previous quarter.
- In India, the Finance Minister (FM) announced a large fiscal stimulus in late September, by slashing corporate tax rates for domestic and new manufacturing companies, in a bid to deal with the current economic slowdown and help promote investment. For domestic company, the corporate tax rate has been reduced to 22% (plus surcharge & cess, effective tax rate 25.17%), from 30% (plus surcharge & cess, effective tax rate 34.94%) earlier. However, this is applicable for companies that are not using any other tax incentives/exemptions. To attract new investment and boost the government's 'Make in India' initiative, the corporate tax rate of new domestic company incorporated from Oct 2019, making new investment in manufacturing will be 15% (plus surcharge & cess, effective tax rate 17.01%). Also, the Minimum Alternative Tax (MAT) has been reduced to 15% from 18.5% earlier. However, the FM forecasted revenue foregone from the tax rate cut and other relief measures at ₹1.45 lakh crore (~0.7% of GDP), which is expected to put pressure on the fiscal deficit front.
- India's current account deficit (CAD) rose to \$14.3 bln in Q1 FY20 (2.0% of GDP), which was better than expectations. CAD was \$4.6bln in Q4 FY19 (0.7% of GDP) and \$15.8 bln (2.3% of GDP in Q1 FY19. The rise in CAD was primarily due to rise in trade deficit to \$46.2 bln in Q1 FY20, from \$35.2 bln in Q4 FY19. However, capital account flows increased to \$27.9 bln in Q1 FY20, from \$19.2 bln in Q4 FY19—primarily helped by pick-up in FDI investments. As result of the strong capital account flows, the balance of payment (BOP) remained in surplus at \$14.0 bln in Q1 FY20, compared to a surplus of \$14.2 bln in the previous, and a BOP deficit of \$11.3 bln in the corresponding quarter—a year ago.
- Consumer Price Index (CPI) headline inflation remained comfortably below RBI's target of 4% and came in at 3.2%YoY in the month of August 2019. Food inflation (biggest component of CPI, with 39% weight) has risen marginally over the past few months, as expected, to 3.0%YoY in August 2019, but still remains in comfortable zone. Core inflation (ex food & fuel) dropped to 4.2%YoY in August.
- Index of Industrial Production (IIP) has been a bit volatile during the course of the fiscal year, but recently picked up to 4.3%YoY in July 2019, from 1.2%YoY in the previous month. The heavy-weight manufacturing sector (78% weight in IIP) growth rose to 4.9%YoY, from 1.5%YoY in the previous month. For FYTD20 (upto July) IIP growth was softer at 3.3%YoY, compared to 5.4%YoY in the corresponding period a year ago.
- In the month of September, crude prices had spiked to around \$69/bbl due to drone attacks on a major Saudi refinery, raising concerns of supply disruption—with Saudi Arabia being one of the largest suppliers of crude oil. However, prices have stabilized, with Saudi Arabia saying that it will normalize supply, and brent crude closed the month at \$60.78/bbl.
- The rupee had depreciated, breaching the 72/USD mark in early September—on the back of foreign portfolio investor (FPI) equity outflows, macro-economic slowdown, depreciation in emerging market currencies, and depreciation in Chinese yuan (vs USD) amidst the trade war. However, the rupee stabilized later, and closed the month at INR70.87 / USD.

Equity market developments and Outlook

- Indian markets delivered healthy returns during the month of September, helped especially by the announcement by the government—of slashing corporate tax rates. The benchmark Nifty 50 index closed the month with a gain of 4.1%, while the broader markets also fared decently, with the Nifty Midcap 50 index and Nifty Smallcap 100 index returning +3.1% and +2.7% respectively. Sectors that outperformed during the month

included oil & gas, consumer durables, capital goods, metals, auto and banks. The sectors that underperformed during the month were realty, IT and pharma.

- Most global markets registered positive returns during the month. The MSCI Asia ex-Japan index and MSCI Emerging Markets index returned +1.4% and +1.7% respectively in September. Meanwhile, developed markets fared slightly better, with the MSCI World Index returning around +2.0%.
- In the US, the S&P 500 index rose by 1.7% in September. Among European markets, Germany and France were among the top performers—with their benchmark indices returning +4.1% and +3.6% respectively during the month. Within Asia—Indonesia, Malaysia and Thailand were the under-performers, while the out-performers within the region were Japan, South Korea and India.
- Foreign portfolio investors (FPIs) registered a net inflow of ₹6,674 crore in the month of September, compared to a net outflow of ₹15,552 crore in the previous month.
- Domestic Institutional Investors (DIIs) registered a net investment in equities of ₹12,491 crore in September, compared to a net investment of ₹20,934 crore in the previous month.
- The government has been proactive and announced a slew of measures to help revive economic growth and improve investor sentiment. We expect economic growth to gradually recover in H2 FY20, and pick up pace in FY21.
- We expect corporate earnings to get a boost as a result of the corporate tax cuts. Nifty index earnings growth is revised upwards by 5-6% to around 21% for FY20 (as per consensus). This should help drive the equity markets going forward.
- With tax rate being reduced to 17% for new manufacturing units, set up till March 2023; private capex should see a revival over the next 18 months. For, global companies looking to diversify their manufacturing operations away from China (due to the ongoing US-China trade war), India is now an attractive proposition (from a taxation perspective).
- Eye needs to be kept on the extent of global growth slowdown, US-China trade war developments, global monetary policy stance, geo-political events, and overall global investor risk appetite—as it will determine the flow into emerging markets like India.
- We recommend investors to systematically invest in equities. We continue to prefer large-caps, but also see some attractive bottom-up opportunities in the mid-cap segment—from a valuation perspective.

Fixed Income market developments and Outlook

- Bond yields rose during the month on the back of fiscal concerns due to the corporate tax cuts, foreign debt outflows, and some intermittent volatility in crude oil prices and the rupee. The 10 year benchmark yield closed the month at 6.70%—up 14 bps.
- The RBI Monetary Policy Committee (MPC) voted to cut the policy repo rate by 25 bps in early October, with all MPC members unanimously voting for a rate cut (5 members for 25 bps cut and 1 member for 40 bps cut). The MPC decided to continue with an 'accommodative' stance as long as it is necessary to revive growth, while ensuring that the inflation remains within the target. Since February 2019, the central bank has cut the policy rate by a cumulative 135 bps.
- RBI's inflation projection has been revised slightly upwards to 3.4% for Q2 FY20 (from 3.1% earlier), while projections were retained for H2 FY20 at 3.5-3.7%. On the economic front, the central bank revised down the GDP growth forecast for FY20 sharply to 6.1%YoY, from 6.9%YoY earlier.
- The government borrowing calendar announced for H2 FY20 remained unchanged at a ₹2.68 lakh crore (on a gross basis), which provided some respite to bond markets, as they were expecting a higher govt. borrowing due to the recent fiscal stimulus announced by the government.
- Fiscal deficit for FYTD 20 (upto August) was 78.7% of the budgeted estimate for entire FY20, compared to 94.7% in the corresponding period in the previous fiscal year. This was primarily on the back of higher dividend from the RBI and with expenditure being in control, despite tax collections (esp. indirect tax collections being below budgeted estimates).
- GST collections for the month of September 2019 (reflecting activity for August) fell to ₹91,916 crore (lowest since the month of February 2018), compared to ₹98,202 crore in the previous month.
- Foreign Portfolio Investors (FPIs) registered a net outflow of around ₹1,900 crore in the month of September, compared to a net inflow of ₹11,415 crore in the previous month.
- Overall, we feel that the RBI rate cut of 25 bps in early October and its commentary was a 'dovish' cut, although some segments of the market were expecting a 35-40 bps cut. With inflation being in control and weak domestic growth prospects, RBI's focus continues to be addressing the slowdown in macro-economic environment. The RBI noted the further widening of the negative output gap, and we believe that the benign inflation outlook provides headroom for further policy action from the central bank.
- From an investment perspective, we presently prefer the shorter to medium term end of the yield curve.